

Message Text

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TAGS: EFIN, UK
SUBJECT: FINANCIAL TIMES EDITORIAL ON STERLING

1. FOLLOWING IS TEXT OF LEAD FINANCIAL TIMES EDITORIAL
DATED JANUARY 11:

THE AGREEMENT ANNOUNCED AT BASLE TO PROVIDE A CREDIT OF \$3 BILLION TOGETHER WITH A BRITISH OFFERING OF FOREIGN CURRENCY DENOMINATED BONDS TO OFFICIAL HOLDERS OF STERLING IS EXCEEDINGLY WELCOME. IT PROVIDES AN OPPORTUNITY TO EMBARK AT LAST IN GOOD EARNEST ON WHAT HAS OFFICIALLY BEEN AN OBJECTIVE OF BRITISH POLICY SINCE THE FIRST APPROACHES TO THE EUROPEAN COMMUNITY TEN YEARS AGO: TO WIND UP THE RESERVE ROLE OF STERLING. IF THE GOVERNMENT IS NOW IN EARNEST, AS INDEED IT APPEARS TO BE, AND IF IT REMAINS IN EARNEST EVEN AFTER THE IMMEDIATE PROBLEMS OF STERLING HAVE RECEDED FROM IMMEDIATE MEMORY, THIS COULD PROVE NOT JUST ANOTHER LOAN, BUT A TURNING POINT.

PRUDENCE. THERE IS NOW A POTENTIALLY HAPPY ENDING TO WHAT HAS BEEN AN INCREASINGLY DISGRACEFUL STORY. SUCCESSFUL
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CESSIVE BRITISH GOVERNMENTS SEEM TO HAVE BEEN GIVING A NON-STOP PERFORMANCE OF TOAD OF TOAD HALL, PROMISING TEARFULLY TO LAY UP THE STERLING VEHICLE AFTER EVERY BAD FRIGHT AND TAKING TO THE ROAD AGAIN WITH A HAPPY BLAST ON THE HORN WHENEVER A NEW OPPORTUNITY WAS DISCERNED TO OBTAIN APPARENTLY PAINLESS FINANCE FOR A PROFLIGATE BALANCE

OF PAYMENTS.

THE LAST CYCLE BEGAN IN 1974, WHEN THE GOVERNMENT WELCOMED THE BUILD-UP OF ENORMOUS LIQUID BALANCES OF OPEC FUNDS, IGNORING THE MOST ELEMENTARY CONSIDERATIONS OF BANKING PRUDENCE. THE SUBSEQUENT RUN ON STERLING HAS BEEN ALMOST AS FRIGHTENING AS A RUN ON A BANK, AND FOR SOME MONTHS THE GOVERNMENT HAD LITTLE OR NO CONTROL OVER THE EXCHANGE RATE (AND THUS THE RATE OF INFLATION) OR THE INTEREST RATE. THIS EXPERIENCE SEEMS AT LAST TO HAVE TAUGHT REAL HEARTFELT PRUDENCE.

THE FACT THAT A FACILITY OF A MERE \$3 BILLION IS PROBABLY ADEQUATE AT THE MOMENT TO FUND ALL OFFICIAL SHORT TERM LIABILITIES IN STERLING, APART FROM GENUINE WORKING BALANCES, SHOWS HOW FAR THE FLIGHT HAS GONE; BUT IT HAS BECOME CLEAR IN RECENT WEEKS THAT THE NEWS OF SOUNDER POLICIES BACKED BY EXTERNAL FINANCE CAN RAPIDLY ATTRACT VERY LARGE REFLOWS. THE GOVERNMENT'S RESPONSE TO AN UPWARD PRESSURE ON STERLING WILL BE THE REAL TEST OF ITS INTENTIONS.

BASICALLY THERE ARE THREE POSSIBLE RESPONSES: TO RELAX EFFORTS TO CORRECT THE BALANCE OF PAYMENTS; TO ALLOW STERLING TO APPRECIATE; OR TO MAINTAIN A STABLE EXCHANGE RATE TAKING THE OPPORTUNITY TO REBUILD THE CURRENCY RESERVES AND TO BASE INTEREST RATE POLICY ON DOMESTIC REQUIREMENTS. THE FIRST ALTERNATIVE IS FORTUNATELY UNTHINKABLE UNDER THE TERMS OF THE LETTER OF INTENT; BUT THE SECOND, WITH ITS PROMISE OF LOWER IMPORT COSTS AND REDUCED INFLATION, COULD PROVE TEMPTING. YET IT IS THE THIRD AND ONLY THE THIRD POSSIBILITY WHICH FITS IN WITH THE GOVERNMENT'S INDUSTRIAL OBJECTIVES, ENCOURAGING IN-

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VESTMENT, AND ACCEPTING A NECESSARY DECLINE IN LIVING STANDARDS.

FOLLOW THROUGH. IT IS EVEN POSSIBLE, AS THE BALANCE OF PAYMENTS IMPROVES TOWARDS THE END OF THE YEAR, THAT THE AUTHORITIES WILL FACE THE SORT OF DILEMMA WHICH HAS IN THE RECENT PAST FACED OTHER COUNTRIES WITH A STRONG BALANCE OF PAYMENTS: HOW TO LIMIT THE GROWTH OF EXTERNAL HOLDINGS OF STERLING. IT IS TO BE HOPED THAT THE GOVERNMENT WILL THEN RETAIN THE SUPPORT OF ITS PRESENT BACKERS IN WHATEVER STEPS ARE NECESSARY TO PREVENT A REBIRTH OF RESERVE STERLING. EXPERIENCE HAS SHOWN THAT IN A WORLD OF FLOATING CURRENCIES, THE WHOLE SYSTEM BECOMES UNSTABLE IF THERE IS ROOM FOR MUCH SWITCHING OF RESERVES. IT IS IN EVERYONE'S INTEREST THAT THE PRESENT AGREEMENT BE FOLLOWED THROUGH.

ARMSTRONG

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